

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Market Dominant Product Prices
First-Class and Standard Mail
Discover Financial Services

Docket No. MC2011-19

Market Dominant Product Prices
Discover Financial Services (MC2011-19)
Negotiated Service Agreement

Docket No. R2011-3

Public Representative Motion for
Issuance of Commission Information Request

(March 21, 2013)

The Commission approved the original NSA in this docket on March 15, 2011.¹ Under that agreement, Discover Financial Services (Discover) would be rewarded with rebates on Presort First-Class and Standard Regular letter mail for exceeding the Postal Service's forecasts of Discover's future spending on postage for those categories of mail. On March 8, 2013, the Postal Service notified the Commission that it has amended that agreement.² In response to that notice, the Commission set a date of March 27, 2013 as the deadline for public comments on the amended NSA.³ The Public Representative hereby moves the Commission to issue a Commission Information Request to obtain information without which the amended NSA cannot be evaluated for compliance with the PAEA.

¹ See Order No. 694.

² Letter of Brandy A. Osimokun to Shoshana Grove, Secretary of the Postal Regulatory Commission, dated March 20, 2013 (Notice).

The Postal Service has amended Section II.B.5 of the Discover NSA to allow Discover to treat the volume of “expedited” mail that Discover intends to substitute for “a small portion of DFS Eligible First-Class Mail volume mail” as though such volume were DFS Eligible First-Class Volume. Under the amended NSA, the Postal Service calculates the postage revenue that such expedited mail volume would have earned had it been mailed DFS Eligible First-Class, and adds that amount to the revenue threshold that triggers rebates or penalties under the Discover NSA.

The Postal Service characterizes this change as “a minor amendment” to the Discover NSA. Notice at 1. It attributes the need for this revision to “DFS’ unforeseen business decision” that requires DFS to “upgrade” DFS Eligible First-Class Mail to Priority Mail. See Attachment to Notice.

The Commission will not be in a position to evaluate the legal or the economic significance of this amendment to the Discover NSA unless it knows how small “a small portion” of DFS Eligible First-Class Mail” is (thousands of pieces? millions of pieces? tens of millions?) Nor will the Commission be in a position to evaluate this revision unless the Postal Service explains what the nature of the relationship is between the new Priority Mail volumes anticipated and the displaced “DFS Eligible First-Class Mail.” An adequate explanation would have to include a straightforward description of the “unforeseen business decision” that necessitates the conversion of some eligible First-Class Mail to Priority Mail.

By characterizing this amendment as “minor,” and not submitting it formally to the Commission for approval, the Postal Service apparently hopes that its amended NSA will receive little, if any, regulatory scrutiny for its compliance with section 3622(c)(10). As the Commission well knows, the viability of the PAEA depends on maintaining the integrity of the wall that it erects between the marketing and pricing of Market Dominant services and the marketing and pricing of competitive services. This wall is the

³ Order No. 1676, Notice and Order Concerning Contract Amendment to Discover Financial

mechanism that prevents the Postal Service from using its market power over Market Dominant products as leverage to gain an advantage in competitive markets. This amendment breaches that wall by using one set of rebates to simultaneously incentivize the purchase by Discover of Market Dominant (Presort First-Class) and competitive services (Priority Mail). As such, it would set a precedent for dismantling one of the most basic safeguards in the PAEA. At the very least, the Commission is obligated to ascertain whether there is a compelling business need to breach this wall, and the magnitude of the breach that the parties contemplate.

In its order that originally approved this NSA, the Commission observed that the NSA as drafted was flawed because it was based on Postal Service forecasts of baseline volume (what volumes would have been without rebates) for Eligible First-Class and Standard letters that avoids using the Commission's approved method of forecasting the impact of discounts on volume, that is, it avoids basing the forecast on the average price elasticities of the affected services. The Commission criticizes the Postal Service for not offering any other objective, qualitative analysis to take its place.

The Commission noted that the Postal Service's forecast of baseline volume in this NSA even avoids any explanation of how the Postal Service combined or weighted the list of qualitative factors that it purports to have considered in making those forecasts. Order No. 694 at 13. The Commission said that it could not endorse baseline volume projections based on such a subjective, non-analytical approach. It observed that "it is incumbent upon the Postal Service to develop a quantitative approach that incorporates the factors it is using to estimate volumes." *Id.* at 14. To remedy this deficiency, the Commission included, as one of the yearly reporting requirements for this NSA, "a *detailed discussion* of how the Postal Service believes DFS's own-price elasticities differ from the average elasticities of workshared First-Class and Standard Regular Mail." (emphasis supplied) *Id.* at 23.

The Postal Service's Data Report on the first contract year of this NSA brushed this reporting requirement aside, stating⁴

The Postal Service can not quantify how DFS' own-price elasticities differ from the average elasticities of work shared First-Class Mail and Standard Regular Mail. The Postal Service does not measure how elasticities differ by customer. Obviously, the large groupings for which we have measures of elasticity are a composite of many customers; each of which may react to price changes differently.

The Postal Service disregards the italicized language in Order No. 694 quoted above. That language asks for a *detailed discussion* of how the Postal Service believes Discover's own-price elasticity for these services differs from the market's average own-price elasticities for these services.

Whether the Postal Service is using a formal model, or an informal, judgmental approach to forecast Discover's response to price rebates, if it identifies a specific number of incremental pieces that Discover will purchase in response to a specific price change, the Postal Service is, by definition, assuming that Discover has a particular own-price elasticity for that service.

The Commission, in Item 9 of its Data Collection Report, is asking the Postal Service to acknowledge, in quantitative terms, how far the own-price elasticity that it has assumed for Discover deviates from the market average, and explain in detail why it believes it deviates to the extent that it does. The fact that the Postal Service didn't use a formal model to estimate Discover's own price elasticity for the affected services is no excuse not to provide such a discussion in its answer to Item 9. If the Commission decides to approve the amended NSA, it should condition its approval on the Postal Service acknowledging the extent to which the own-price elasticities that it implicitly assumes for Discover

⁴ Discover Financial Services Negotiated Service Agreement Data Collection Report (April 1, 2011 – March 31, 2012), Postal Service Response to Item 9.

differ from the relevant market averages, and providing a detailed discussion as to why, in compliance with Order No.694.

For the foregoing reasons, the Public Representative moves the Commission to issue a Commission Information Request to the Postal Service that asks it to answer the following questions:

1. Please provide your forecast of the number of pieces of Eligible First-Class Mail that will be displaced by Priority Mail in contract year three of the amended NSA.
2. Please describe the nature of Discover's "unforeseen business decision" that requires it to upgrade a portion of Eligible First-Class volume to "an expedited service."
3. Please describe the relationship between the "expedited service" and the Eligible First-Class Mail that it will displace.
4. Please state whether Discover is, or plans to be, a party to any other NSA that involves "an expedited service" while this amended NSA is in effect.
5. Please calculate how far the own-price elasticity that the Postal Service has implicitly assumed for Discover deviates from the market average for Presort First-Class Mail, and for Standard Regular Mail, respectively.
6. Please explain in detail why these implicit own-price elasticities deviate from the market average to the extent assumed.

Respectfully submitted

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